STATE OF ALABAMA

DEPARTMENT OF INSURANCE

MONTGOMERY, ALABAMA

REPORT ON EXAMINATION

as of

DECEMBER 31, 1998

of

CHATTAWOOD INSURANCE COMPANY, INC.

VALLEY, ALABAMA

PARTICIPATION:

Alabama

EXAMINATION AFFIDAVIT

STATE OF ALABAMA
COUNTY OF MONTGOMERY

Rex H. Newborn being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of Chattawood Insurance Company, Inc. for the period of January 1, 1994 through December 31, 1998;

That the following 22 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And, that the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.

Rex H. Newborn
Examiner-in-charge

Subscribed and sworn to before the undersigned authority this 30th day of December, 1999.

(Signature of Notary Public)

Sandra J. Fuller, Notary Public
Printed name

in and for the State of Alabama

My commission expires My Commission Expires 9/10-2001

TABLE OF CONTENTS

(continued next page)

TABLE OF CONTENTS (continued)

GOVERNOR
DON SIEGELMAN

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
201 Monroe Street, Suite 1700
Post Office Box 303351
Montgomery, Alabama 36130-3351
Telephone: (334) 269-3550
Facsimile: (334) 240-3194

ACTING COMMISSIONER
D. DAVID PARSONS

Chief Examiner
Richard L. Ford

State Fire Marshal
John S. Robison

General Counsel
Michael A. Bownes

Valley, Alabama
December 30, 1999

Honorable David Parsons
Acting Commissioner of Insurance
State of Alabama
Post Office Box 303350
Montgomery, Alabama 36130-3350

Dear Commissioner Parsons:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, an examination has been made of the affairs and condition of

Chattawood Insurance Company, Inc.
Valley, Alabama

as of December 31, 1998, at its home office located at 360 Fob James Drive, Valley, AL 36854. The report of examination is submitted herewith.

Where the term, Company, appears herein without qualification, it is synonymous with Chattawood Insurance Company, Inc.

SCOPE OF EXAMINATION

The examination reported herein covers the period from December 31, 1993 through December 31, 1998, and has been conducted by examiners representing the Alabama Department of Insurance. Events subsequent to December 31, 1998, have been reviewed as required and are reported herein as deemed appropriate.

The Company has been examined in accordance with the statutory requirements of the Alabama Insurance Code and the regulations and bulletins of the Alabama Department of Insurance; in accordance with the applicable guidelines and procedures of the NAIC; and in accordance with generally accepted examination standards.

The examination included a general review of the Company's operations, administrative practices and compliance with statutes and regulations. Income and disbursement items were tested for selected periods. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 1998, as shown in the financial statements contained herein.

In compliance with requirements of the Alabama Department of Insurance, the President and Treasurer of the Company executed a letter of representation certifying that the Company had valid title to all its reported assets, and that it did not have unreported liabilities as of December 31, 1998.

Within this report, discussion of the Company's accounts has been confined to those items for which a material change in the financial statements has been noted or for which comments and/or recommendations have been made.

ORGANIZATION AND HISTORY

The Company was incorporated in the State of Alabama as a property and casualty insurance company, on August 26, 1987. The Company has been wholly owned by J. T. Lanier & Associates, Inc., from its inception through the date of this report.

The Company's Articles of Incorporation (Articles) provided for 2,000,000 shares of $1.00 par value common stock. The initial capitalization was derived from the sale of 1,250,000 shares of said common stock, at a price of $1.00 per share. The Articles were amended September 28, 1988, to reduce the par value of the common stock to $.40 per share, thereby providing for $500,000 of paid up capital and $750,000 of paid in surplus. There have been no further changes in the Company's capital structure through the date of this report.

The Company's only business has been reinsurance assumed from two companies who are members of the Old Republic International holding company system. This reinsurance was terminated in 1992, and there is ongoing litigation in relation thereto at the date of this report. See "Reinsurance," page 10 for further discussion.

GROWTH OF THE COMPANY

The following schedule presents financial data, which reflect the growth of the Company for the years indicated:

Year	*Premium Income*	*Admitted Assets*	*Liabilities*	*Capital & Surplus*
1993	$1,498,659	$3,813,483	$2,502,708	$1,310,775
1994	19,998	3,293,089	2,031,036	1,262,053
1995	0	3,369,370	1,492,155	1,877,215
1996	0	3,735,936	1,161,754	2,574,182
1997	0	3,664,214	859,531	2,804,683
1998	0	3,452,233	886,166	2,566,067

Data for the years 1993 and 1998 are per examination. Data for the remaining years were obtained from the Company's Annual Statements.

CORPORATE RECORDS

The Company's Articles of Incorporation and Bylaws were reviewed and found to provide for operation of the Company in accordance with Alabama statutes and regulations and in accordance with accepted corporate practices.

The minutes of the meetings and actions of the Shareholder and Board of Directors, from January 1, 1994 through the most recent meetings were reviewed. They appeared to be complete and to adequately document the resolutions and actions of said corporate bodies.

MANAGEMENT AND CONTROL

Stockholder

J. T. Lanier and Associates, Inc. has been the sole stockholder of the Company from its inception through the date of this report.

Board of Directors

The Bylaws provide that the Company's business, affairs and property shall be managed by a Board of Directors (Board) consisting of not less than three, nor more than seven directors, at least one third of whom must be bona fide residents of Alabama. Directors need not be stockholders. Directors shall be elected at the annual meeting of the stockholder and hold office for one year, or until successors are elected and qualified.

The following directors were elected at the annual meeting of the sole stockholder on April 9, 1998:

Director/Residence	*Principal Occupation*
John Thompson Lanier Valley, Alabama	President, J.T. Lanier & Associates, Inc.
Donald Lee Rush Lanett, Alabama	Retired
William Thomas Parr West Point, Georgia	Vice Chairman, J. Smith Lanier & Company, Inc.
William Henry Scott, III West Point, Georgia	President, ITC Holding Company, Inc.

Committees

No Board appointed committees were in evidence during the examination period.

Officers

The Bylaws provide that the officers of the corporation shall be elected at the regular annual meeting of the Board, and shall consist of a President, who shall be a director, one or more Vice Presidents, a Secretary, a Treasurer, and any other officers at the discretion of the Board. Officers hold office until the next annual meeting of the Board, and until successors are elected and qualified. Any two offices may be held by one person, except the offices of President and Secretary.

The following officers were elected by the Board of Directors on April 13, 1999:

John Thompson Lanier	President
Donald Lee Rush	Vice President and Treasurer
Ann Brewer Adams	Secretary
Pamela Fetner Lindsay	Assistant Secretary

Conflict of Interest

The Company's conflict of interest policy requires that all officers, directors and persons charged with handling Company funds complete annual conflict of interest statements. Said conflict of interest statements are designed to disclose, to the Board, any interest which the respondent has, which might be in conflict, or potential conflict, with the interest of the Company.

Conflict of interest statements completed by all officers and directors of the Company during the examination period were reviewed. No persons handling Company funds, other than officers and directors, were identified. No conflicts of interest were reported.

It was noted that payments for "Other Compensation" were reported in the Company's 1998 and 1997 Annual Statements, in the amounts of $59,283 and $89,800, respectively. These payments were determined to have been paid to one director and two officers of the Company. Said payments were approved by the Board; and, according to the Company's President, the payments were made for services rendered in relation to the Company's arbitration and litigation efforts against Old Republic. However, no documentation was provided to the examiner as to the exact nature of the services rendered.

Such payments to directors and/or officers are in violation of Section 27-27-26, *Code of Alabama*, 1975, unless the payments are for legal services actually rendered. In addition, Section 27-27-30, *Code of Alabama*, 1975, requires that any disbursement for more than $25 for services shall be evidenced by a voucher or other document which describes the services and itemizes expenditures. In the absence of documentation of the services rendered, the examiner could not determine whether a violation of the former aforesaid statute occurred. However, the absence of such documentation constitutes a violation of the later aforesaid statute.

HOLDING COMPANY AND AFFILIATES

Holding Company Registration and Reporting

The Company is deemed to be subject to the Alabama Insurance Holding Company Regulatory Act of 1973, as defined in Section 27-29-1, *Code of Alabama,* 1975. The Company is responsible for holding company registration and periodic informational filings with the Alabama Department of Insurance (Department), in accordance with Section 27-29-4, *Code of Alabama*, 1975, and Alabama Department of Insurance *Regulation Number 55.*

Holding company filings and amendments to registration statements made on behalf of the Company and its affiliates, for the years under examination, were reviewed. Said filings and amendments were found to be substantially complete and to reflect the required disclosures.

Organizational Chart

The organizational chart on the following page depicts the insurance holding company system with which the Company was affiliated as of December 31, 1998.

Organizational Chart

(I)ULTIMATE OWNERSHIP RELATIONSHIPS

Percentage of Voting Stock/Ownership

	J. T. Lanier & Assoc, Inc. (Holding Co.)	R & L Properties
John Thompson Lanier	100%	50%
Donald Lee Rush		50%
Total	100%	100%

J. T. LANIER & ASSOCIATES, INC.
(A Georgia Corporation)
(58-1648488)
(I)

100%

CHATTAWOOD INSURANCE COMPANY, INC.
(An Alabama Corporation)
(63-0981279)

Changes in the Ownership and Control of Affiliates

During the examination period there were several changes in the ownership and control of the Company and its affiliates, none of which were deemed to require a Form A filing with the Department. At the beginning of the examination period, the holding company, J. T. Lanier & Associates, Inc. (JTL) was owned 57% by the estate of Campbell B. Lanier, Jr. and 43% by John Thompson Lanier. During 1998, Mr. Lanier acquired 100% ownership of the Company.

John Thompson Lanier also owned a sole proprietorship insurance agency that did business as J. T. Lanier and Associates. This agency was incorporated in 1993, as J. T. Lanier and Associates of Alabama, Inc., which was subsequently owned two-thirds by Mr. Lanier and one-third by Donald Lee Rush. (This agency in both its proprietorship and corporate forms is referred to throughout the report as JTL Agency).

During 1997, 51% of JTL Agency was sold to an outside party and the name was changed to Davis-Garvin of Alabama, Inc. (DGA). Mr. Lanier retained 33% ownership and Mr. Rush retained 16% ownership of DGA. During 1998, Mr. Lanier and Mr. Rush divested all their interest in DGA.

Transactions with Affiliates

The Company entered into a "Management Contract" with it parent, J. T. Lanier and Associates, Inc., effective January 1, 1998 to December 31, 1998. This agreement was approved by the Department in December of 1998, but it was not renewed by the Company on January 1, 1999.

The Company has disclosed in its Form B filings since 1994 that it has had management and service contracts and/or cost sharing arrangements with affiliates. The following payments to affiliates were reported in the Annual Statements during the examination period:

(continued next page)

Year	*Affiliate*	*Amount*
1994	J. T. Lanier & Associates, Inc.	$ 25,000
1995	J. T. Lanier & Associates, Inc.	6,000
	R&L Properties	12,000
1996	J. T. Lanier & Associates, Inc.	6,000
	R&L Properties	12,000
1997	J. T. Lanier & Associates, Inc.	21,500
1998	J. T. Lanier & Associates, Inc.	132,000

The payments to R&L Properties were for rental of floor space in a building which housed the affiliates. The Company was instructed, by the Department, that said rental payments constituted a violation of the Alabama pecuniary interest statutes, and the practice was subsequently discontinued.

FIDELITY BOND AND OTHER INSURANCE

The Company had fidelity bond coverage issued by Western Surety Company. This bond provided coverage in the amount of $100,000 against losses from dishonest acts of Company personnel.

Other insurance coverages maintained by the Company, at December 31, 1998, included Workers' Compensation and a variety of coverages under a Business Liability Umbrella policy issued by The Hartford.

The coverages and limits of the Company's insurance were deemed to meet the NAIC minimum requirement for fidelity bond coverage and to adequately protect the Company's interest.

SPECIAL DEPOSITS

In accordance with the statutory requirements for transacting insurance business in the State of Alabama the Company maintained the following deposits with the State of Alabama, at December 31, 1998 (held for the benefit of all policyholders, claimants, and creditors of the Company):

(continued next page)

	Par Value	Statement Value	Market Value
U.S. Treasury Note, 6.375%, due 7/15/1999	$ 50,000	$ 50,469	$ 50,500
U.S. Treasury Note, 5.375%, due 1/31/2000	50,000	49,976	50,500
Totals	$100,000	$100,445	$101,000

At December 31, 1998, the Company maintained the following deposits (not for the benefit of all policyholders) for the purpose of securing assumed reinsurance, up to 102% of the related reinsurance liabilities:

	Par Value	Statement Value	Market Value
Various bonds and stocks	$2,331,347	$2,312,064	$2,247,563

REINSURANCE

The Company has not ceded any reinsurance during its history. The reinsurance discussed herein is run-off business of assumed reinsurance which derives from contracts cancelled in 1992.

Reinsurance Assumed

Effective May 1, 1987, the Company entered into identical reinsurance agreements with Old Republic Insurance Company (ORI), a Pennsylvania domestic company, and Old Republic Union Insurance Company (ORU), an Illinois domestic company. Until 1992 ORU was domesticated in Alabama under the name, Capital Fire and Marine Insurance Company. (Hereafter, ORI and ORU are referred to collectively as Old Republic or the Old Republic companies).

In conjunction with the reinsurance agreements, an agency agreement was effected between Old Republic and J. T. Lanier & Associates (JTL Agency), an affiliate of the Company. The agency agreement was cancelled, and the reinsurance agreements were cancelled for new business, effective October 26, 1992.

In accordance with the reinsurance and agency agreements, JTL Agency sold several lines of property and casualty insurance, written by Old Republic, to the timber and logging industry in Alabama, Georgia and Florida. Workers' compensation insurance accounted for the larger share of the premiums. The agreements also provided for the Company to assumed a 25% quota share of the first $300,000 of loss (maximum $75,000 for any one loss, any one insured) on business produced by JTL Agency for Old Republic. A Florida agency, Chancy-Stoutamire, Inc. (CSI) also produced this business, as a sub-agent of JTL Agency until the time of the cancellation of the agreements with Old Republic. After the cancellation of the agreements, Old Republic continued to use CSI to produce the business, but did not reinsure the business with the Company.

Litigation with Old Republic, et al

The Company filed suit against Old Republic, CSI and certain entities and individuals who were representatives of Old Republic and CSI, claiming breach of contract and fraud. In April of 1995, the dispute was subjected to arbitration, and in July of 1995 the arbitration panel issued a final order that was generally favorable to the Company. However, the Company was not satisfied that Old Republic's complied with the terms of the order, and in April of 1996, the Company filed a motion in federal court to enforce the order. In August of 1996, a ruling was issued by the federal court clarifying and confirming the arbitration order. Subsequently, the Company filed a motion in the federal court to hold Old Republic in contempt, because Old Republic was still not in compliance with the Company's interpretation of the arbitration order and related court rulings.

In January of 1997, the Company and Old Republic signed a settlement agreement which resolved most of the disputes regarding the interpretation of the arbitration order. However, disagreement continued as to the amount of reserves which should be carried by the Company. Also, in March of 1997, it was discovered claims that there were claims ceded to the Company for which the corresponding premium had not been not ceded, which was not in accordance with the arbitration order. Subsequently, the Company filed additional motions for contempt, against Old Republic, in the federal court. Said contempt motions remain pending as of the date of this report.

In August of 1997, the Company entered into limited settlement agreements with CSI and Old Republic's claims adjustment company, which resulted in a total recovery of $275,000 by the Company.

MARKET CONDUCT

Territory

The Company is licensed to write property and casualty insurance in Alabama only. The certificate of authority was inspected and found to be current.

Plan of Operation

The Company has never written any direct business. Historically, the operations of the Company have been limited to reinsurance of business written by the Old Republic companies. The Old Republic policies reinsured by the Company were sold to the logging industry by J. T. Lanier and Associates, an agency affiliated with the Company. The business consisted primarily of workers compensation, with lesser amounts of general liability, auto liability, inland marine and property insurance.

The reinsurance contracts with Old Republic were cancelled in 1992, and the Company has been dormant except for the run-off of reinsurance claims. Since 1992, there has since been a series of disputes, involving both arbitration and litigation, between Old Republic and the Company. These matters are not completely resolved as of the date of this report. The President of the Company stated that it was not expedient for the Company to pursue additional business until the conflicts with Old Republic are finally resolved.

Policy Forms and Underwriting

The Company has never solicited direct business, and has never submitted any policy forms to the Alabama Department of Insurance.

Compliance With Agents' Licensing Requirements

The Company did not have any licensed agents during the examination period.

Advertising

The Company did not do any advertising to the public, during the examination period.

Claims Payment Practices

The Company has never had any direct policyholders, and the Alabama Department of Insurance has no record of any complaints against the Company.

ACCOUNTS AND RECORDS

Internal Records

The Company's general ledger and other incidental records are maintained manually, with some use of personal computers equipped only with Windows 95 software. The Company's insurance records, such as policy, claims, loss data, etc. are generated by the Old Republic companies and periodically reported to the Company. The Company's records were deemed to be adequate for statutory reporting purposes.

External Audits and Actuarial

The Company is audited annually by the certified public accounting firm, Ernst & Young, LLP (E&Y). The examiners obtained E&Y's audit reports and conversed with persons responsible for the Company's audits. The audit workpapers were not obtained because it was not deemed cost efficient to do so, in view of the brevity of the examination. The Company's actuarial certifications are also done by E&Y, and were reviewed by the examiner. It was not deemed cost efficient to assign an actuarial consultant to the examination team, because the Company's only business is reinsurance which has been in run-off since 1992.

Year 2000 Readiness

Year 2000 readiness appears to be of minimal concern in regard to the internal records of the Company, due to the Company's lack of reliance on electronic data processing. An evaluation of the year 2000 readiness of the Old Republic companies was deemed to be beyond the scope of this examination.

FINANCIAL STATEMENTS

Financial statements included in this report, which reflect the financial condition of the Company at December 31, 1998, and its operations for the years under examination, consist of the following:

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS ARE AN INTGRAL PART THEREOF.

STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS

For the Period Ended December 31, 1998

ASSETS

	Ledger Assets	*Non-Ledger Assets*	*Non-Admitted Assets*	*Admitted Assets*
Bonds	$ 1,555,636	-		$ 1,555,636
Common stocks	862,670	-	$ 8,149	854,521
Cash on deposit	118,169	-		118,169
Short-term Investments	894,500			894,500
Interest , dividends and real estate income due and accrued	29,407			29,407
Cash value - life insurance	48,742	-	48,742	-
Total Assets	$ 3,509,124	$ -	$ 56,891	$ 3,452,233

LIABILITIES SURPLUS AND OTHER FUNDS

Liabilities			
Losses (***Note-1***)			$ 102,179
Reinsurance payable on paid losses and loss adjustment expenses (***Note-2***)			783,987
Other Expenses (***Note-3***)			51,268
Taxes, Licenses and Fees (***Note-3***)			775
Total Liabilities			$ 938,209
Surplus and Other Funds			
Common capital stock		$ 500,000	
Gross paid in and contributed surplus	$ 750,000		
Unassigned funds (surplus) (***Note-4***)	1,264,024		
Total surplus		2,014,024	
Surplus as regards policyholders			2,514,024
Total liabilities, surplus and other funds			$ 3,452,233

STATEMENT OF INCOME

For the Periods Ended,

	December 31, 1998	*December 31, 1997*	*December 31, 1996*	*December 31, 1995*	*December 31, 1994*
Underwriting Income					
Premiums earned	$ -	$ -	$ -	$ -	$ (161,367)
Deductions:					
Losses incurred	$ 26,635	$ (181,117)	$ 27,800	$ (475,681)	$ (562,190)
Loss expenses incurred	-	-	(72,062)	(113,909)	154,845
Other underwriting expenses incurred (***Note-3***)	493,834	592,963	240,095	329,845	207,189
Total underwriting deductions	$ 520,469	$ 411,846	$ 195,833	$ (259,745)	$ (200,156)
Net underwriting gain (loss)	$ (520,469)	$ (411,846)	$ (195,833)	$ 259,745	$ 38,789
Investment Income					
Net investment income earned	$ 133,612	$ 128,892	$ 132,694	$ 252,347	$ 165,379
Net realized capital gains (losses)	159,710	56,866	36,907	139,179	100,222
Net investment gain (loss)	$ 293,322	$ 185,758	$ 169,601	$ 391,526	$ 265,601
Other Income					
Fees income	$ 68,200	$ 116,239			
Payroll and expense reimbursement			$ 378,011	$ 146,536	
Litigation recoveries	615	275,000	-	-	
Total other income	$ 68,815	$ 391,239	$ 378,011	$ 146,536	
Net income	$ (158,332)	$ 165,151	$ 351,779	$ 797,807	$ 304,390

RECONCILIATION OF SURPLUS AS REGARDS POLICYHOLDERS

For the Periods Ended,

	December 31, 1998	*December 31, 1997*	*December 31, 1996*	*December 31, 1995*	*December 31, 1994*
Surplus as regards policyholders, January 1,	$ 2,804,683	$ 2,574,182	$ 1,987,215	$ 1,262,053	$ 1,310,775
Net income	$ (158,332)	$ 165,151	$ 351,779	$ 797,807	$ 304,390
Net unrealized capital gains or (losses)	(132,327)	65,350	59,049	14,640	(90,115)
Change in non-admitted assets	-	-	-	(48,742)	
Change in excess of statutory reserves over statement reserves	-	-	311,254	(38,838)	(272,416)
Prior years taxes	-	-	-	-	9,419
Prior period adjustment	-	-	(135,115)	295	-
Change in surplus as regards policyholders	$ (290,659)	$ 230,501	$ 586,967	$ 725,162	$ (48,722)
Surplus as regards policyholders, December 31,	$ 2,514,024	$ 2,804,683	$ 2,574,182	$ 1,987,215	$ 1,262,053

CAPITAL GAINS AND LOSSES

For The Year Ended December 31, 1998

	Profit on Sales or Maturities	*Loss on Sales or Maturities*	*Difference Between Book and Admitted Values*	*Total Gain or (Loss)*
Bonds	$ 2,680	$ -		$ 2,680
Common stocks (unaffiliated)	190,748	34,217	$ (132,327)	24,104
Short-term investments	599	-	-	599
Totals	$ 194,027	$ 34,217	$ (132,327)	$ 27,383
Net realized capital gains				$ 159,710
Net unrealized capital losses				$ (132,327)

NOTES TO THE FINANCIAL STATEMENTS

Note 1 - Losses **$102,179**

The amount of the captioned liability is the same as reported in the Company's 1998 Annual Statement. This amount was certified by a qualified actuary representing the certified public accounting firm, Ernst & Young, LLP.

The examiner reviewed the loss reserves reported by the Company, and the underlying data, for reasonableness and historical consistency. It was deemed that any variance from the captioned amount would be unlikely to have a material impact on the Company's financial position, considering the current amount of the Company's surplus and its dormancy for new business. It was not deemed cost efficient to assign an actuary to the examination team.

The entire amount of the loss reserves derived from reinsurance assumed from the Old Republic companies, which has been in run-off since 1992. It was noted that there has been ongoing litigation between the Company and Old Republic since 1992; and, the amount of IBNR reserve which should be carried on this business has been a part of the dispute.

A confirmation obtained from Old Republic stated the IBNR reserve at $418,456 more than the $32,828 developed by the Company. However, the amount confirmed by Old Republic did not agree with Old Republic's monthly reports to the Company. Furthermore, Old Republic's September 30, 1999 quarterly summary, although not in agreement with their monthly reports for the same period, reflected IBNR reserves in the amount of $177,200. The confirmation from Old Republic was not accepted, by the examiner, because the IBNR reserve confirmed was not consistent with other Old Republic reports. Furthermore, the amount of IBNR reserve confirmed by Old Republic did not appear to be reasonable in relation to the amount of business reinsured and the fact that no new claims have been filed on this business within the past five years.

Note 2 – Reinsurance Payable on Paid Loss and Loss Adjustment Expenses **$783,987**

The captioned liability was reported erroneously in the Company's 1998 Annual Statement, as "Amounts Withheld or Retained by Company for the Account of Others." It has been reclassified in this report, under the above caption, in accordance with NAIC Annual Statement Instructions. It was also noted that the Company did not complete Schedule F, Part 1, columns 8 and 10, in the 1998 Annual Statement.

The amount of the liability was also determined to be $17,723 more than the amount reported by the Company. However, the difference was not deemed to be material and no related change has been made in the financial statements of this report. The $17,723 examination difference was determined as follows.

The Company maintained assets in custodial accounts that were pledged, for the benefit of the reinsureds, as security for reinsurance balances payable. Said custodial accounts specify that the Company may withdraw any assets in excess of 102% of the amount of the reinsurance liabilities secured. Such pledged assets are admissible only as an offset to the amount of any related liabilities. For financial reporting purposes, the 2% excess requirement may be reported either as assets not admitted, or as an increase to the offsetting liability. For the purposes of this report, the examiners choose to increase the liability amount.

The amount of reinsurance balances subject to the custody requirements at December 31, 1998 was the captioned $783,987, plus the $102,179 amount discussed in "Note 1 – Losses," or $886,166. The 102% funding requirement applied to this $886,166 amount resulted in a total offset amount of $903,889. Therefore, the Company's liability for reinsurance payable on paid losses and loss adjustment expenses has been calculated as $903,889, less the $102,179 reported as losses, equals $801,710, which is $17,723 more than the amount reported in the 1998 Annual Statement.

Note 3 – Other Expenses **$51,268**
Taxes, Licenses and Fees **$775**

The captioned liabilities were not reported in the Company's 1998 Annual Statement. Said liabilities were established by the examination as a result of a review of cash disbursement made in 1999. The captioned amounts were identified as fees of regulatory agencies and other expenses that were paid in 1999, but incurred prior to December 31, 1998.

Note 4 – Unassigned Funds (Surplus) **$ 2,514,024**

The amount of the Company's unassigned surplus, at December 31, 1998, as determined by the examination is $52,043 less than the $2,566,067 amount reported in the Company's 1998 Annual Statement. This difference is entirely the result of the liabilities established, per examination, in the preceding "Note 3 – Other Expenses / Taxes, Licenses and Fees."

CONTINGENT LIABILITIES AND PENDING LITIGATION

Examination of these items included: a review of the Company's statutory financial statements disclosures; performance of the usual search for unrecorded items; obtaining letters of representation from management; and, a review of the external auditors inquiry letter to the Company's outside counsel.

No material unreported contingencies, and no outstanding litigation against the Company, was disclosed or determined by the examination. The litigation between the Company and Old Republic is discussed under the caption "Reinsurance," and mentioned in various other sections of this report.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

The Company appeared to have complied with all recommendations included in the last prior report of examination on the Company.

COMMENTS AND RECOMMENDATIONS

Conflict of Interest - Page 5

It is recommended that the Company document any payments, in addition to salaries, to directors and/or officers in accordance with Section 27-27-30, *Code of Alabama*, 1975. It is further recommended that the Company review any such payments to assure that they comply with the provisions of Section 27-27-26, *Code of Alabama*, 1975.

Losses – Page 18

It was noted that the Company and its ceding reinsurers disagreed over the amount of IBNR reserve that should be carried by the Company at December 31, 1998. The amount of the disagreement was $418,456, a material amount. The examiner accepted the amount as reported in the Company's 1998 Annual Statement, for reasons which are discussed in "Reinsurance," page 10, and "Note 1 – Losses," page 17.

<u>Reinsurance Payable on Paid Losses</u> – Page 18

It is recommended that the Company calculate, and report in its statutory financial statements, the full amount of any liability for reinsurance deposits, in accordance with the terms of its reinsurance agreements and related custodial agreements (i.e. 102% of reinsurance balances payable in the case of the agreements with Old Republic).

It is also recommended that the Company report this liability under the proper Annual Statement caption in accordance with NAIC Annual Statement Instructions.

It is further that the Company complete Schedule F, Part 1, columns 8 and 10, in the Annual Statements.

<u>Other Expenses / Taxes, Licenses and Fees</u> – Page 19

It is recommended that the Company determine and/or estimate the amounts of its liabilities for other (underwriting) expenses, and taxes, licenses and fees, that are accrued at the end of any reporting period. Said liabilities should be reported in statutory financial statements in amounts that are sufficient to assure that they are not understated, in accordance with Section 27-36-1 (5), *Code of Alabama*, 1975.

CONCLUSION

In concluding this Report on Examination, as of December 31, 1998, of Chattawood Insurance company, Inc., acknowledgment is hereby made of the courtesy and cooperation extended by all persons representing the Company during the course of the examination.

The customary examination procedures, as recommended by the National Association of Insurance Commissioners for health maintenance organizations, have been followed in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

Respectfully submitted,
December 30, 1999

Rex H. Newborn

Rex H. Newborn, CFE
Examiner-in-Charge
Alabama Department of Insurance